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SUBJECT: TAIWAN'S AIR CARGO MARKET LOSING ALTITUDE

REF: TAIPEI 3752

Classified By: AIT Director Douglas H. Paal, Reason 1.4 d

Summary

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1. (U) Taiwan's international air cargo volume grew by a minuscule 0.7 percent in the first half of 2005 after a decade of nearly uninterrupted strong growth. Although transit cargo increased, exports and imports both declined. July monthly figures showed declines across all three categories. The movement of Taiwan's IT manufacturing to the PRC is largely to blame. The PRC accounts for the largest share of cargo volumes for Taiwan's carriers. They are using various strategies, including investment in PRC carriers, to access the PRC market in the absence of direct air links. Air cargo will continue to be an important part of Taiwan carriers' strategy, but Taiwan will be of declining importance as a source or destination of cargo. End Summary.

Taiwan Air Cargo Market in Decline

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2. (U) Taiwan's international air cargo volume barely changed in the first half of 2005 from the same period in 2004 after a decade of strong growth interrupted only by a one year of decline during Taiwan's recession in 2001. More disturbing for Taiwan cargo carriers, export and import air cargo volumes dropped 3.6 percent and 5.4 for the first half respectively. Only because of 14.4 percent growth in transit volume was total cargo able to eke out anemic 0.7 percent growth. Air cargo volumes for Taiwan's two international airports, Chiang Kai-Shek International and Kaohsiung International, released by the Ministry of Transportation and Communication (MOTC) are provided below in metric tons:

Year	Total	Import	Export	Transit
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2001	1,278,618	433,502	607,824	237,293
2002	1,476,530	460,002	684,542	331,986
2003	1,584,673	465,237	726,441	392,995
2004	1,788,778	525,807	735,346	527,625
Jan-Jun	852,045	252,937	360,425	238,684
2005				
Jan-Jun	857,820	243,831	340,944	273,048

3. (U) The latest figures for July 2005 offer no reassurance. Total volume was down 5.6 percent from the same month in 2004. Export and import volumes were down 8.6 percent and 3.4 percent respectively. Even transit volume fell 3.8 percent. These data suggest the trend could worsen.

Factories Moving Instead of Cargo

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4. (C) Taiwan's air cargo traffic is dominated by electronic goods, which accounted for 63.2 percent of exports and 25.3 percent of imports. The category of "other manufactured goods" accounted for most of the rest with 29.7 percent of exports and 42.3 percent of imports. The decline in export volume may be due in large part to the transfer of Taiwan's IT manufacturing to the PRC. The shipment from Taiwan of high-tech components used to assemble electronic consumer goods in the PRC was an important component of earlier growth in air cargo. However, as increasingly advanced manufacturing from farther up the supply chain moves to the Mainland, electronics exports to the PRC shipped by air are likely to continue to

decline. DHL Taiwan Director of Operations Nick Chen identified the movement of Taiwan's entire notebook PC manufacturing industry to the PRC as the major cause of declining cargo volumes. He added that TFT-LCD panels produced in Taiwan would not reverse the decline as some had hoped. He speculated that the panels will increasingly be shipped by sea as the market supply stabilizes.

#### PRC Market Dominance

15. (U) MOTC air cargo statistics confirm the importance of the PRC market to Taiwan carriers, but the exact volume is difficult to estimate because MOTC data includes the PRC in "other Asia areas." This category accounted for 20.8 percent of exports and 8.3 percent of imports. Trade with the United States, Japan, and Hong Kong made up most of the rest, accounting for 17.6 percent, 13.5 percent, and 11.8 percent of exports respectively, and 22.9 percent, 20.9 percent and 10.3 percent of imports respectively.

16. (C) MOTC does not release source or destination data on transit cargo. Nevertheless, increasing transit volumes suggest that much of it is cargo originally from the PRC in transit to the United States and elsewhere. EVA Air Deputy Senior Vice President for Cargo Management J.J. Lin (Jyh-jong) told AIT/T that the Greater China market accounts for 40 percent of EVA's total air cargo.

#### Challenge: Getting PRC Cargo on Taiwan Planes

17. (C) PRC carriers have had a shortage of air cargo capacity, but are moving quickly to increase it. CAL and EVA rank fifth and seventh respectively among international air carriers in terms of cargo capacity, and will continue to expand capacity in the next few years despite discouraging trends in the Taiwan market. CAL President Philip Wei told AIT/T that CAL will take delivery of three more 747 freighters by 2007 and is in talks with Boeing to buy more. EVA plans to convert eight 747 passenger jets to freighters between 2007 and 2009. The challenge these carriers face is taking advantage of China's current capacity shortage despite being handicapped by the lack of direct air links.

18. (C) CAL, EVA and even some of Taiwan's smaller carriers have been resourceful at finding ways to tap the PRC's air cargo market. RefTel reported China Airlines purchase, together with Taiwan-based shipping lines Wan Hai Lines and Yang Ming Marine Transport and Belgium's air cargo carrier CargoLux, of a 49 percent stake in PRC cargo carrier Yangtze River Express. CAL's Wei told AIT/T that his firm has abandoned plans to invest in China Cargo Airlines, but maintains cooperative arrangements with several PRC carriers that allow it to carry PRC cargo out of Hong Kong. He added that CAL even carries cargo from the PRC that is shipped by sea from Xiamen to Kaohsiung.

19. (C) Not to be outdone, EVA Airways signed a joint venture agreement with Shanghai Airlines to form an air cargo firm on September 30. EVA's parent conglomerate, Evergreen, will pay RMB 200 million (about USD 25 million) for a 45 percent stake in the venture. EVA will hold 25 percent and other Evergreen units will hold the remaining 20 percent. According to EVA's Lin, the airline had already arranged with Shanghai Airlines to purchase the entire capacity of five weekly cargo flights from Shanghai to Macau. This cargo is transferred to EVA aircraft in Macau. EVA also uses Xiamen-Kaohsiung marine shipping to route PRC cargo onto EVA planes.

110. (U) In addition, Taiwan's TransAsia Airlines is working on an alliance with Xiamen, Yunnan and Shanghai Airlines to move cross-Strait transit cargo. EVA and CAL together partnered with Far Eastern Air Transport (FAT) and Taiwan Airport Service Company (TASC), to buy 49 percent of Xiamen Air Cargo Warehouse Co (refTel).

111. (C) At the same time, Taiwan's large carriers are hoping and preparing for direct cross-Strait air links. EVA's Lin told us that his firm is prepared to take advantage of any breakthrough quickly, but claimed he had no idea when such a breakthrough might occur. CAL's Wei also denied

knowing how soon the two sides might reach an agreement on direct flights. However, he did say that he "knew" that they Taiwan and the PRC have agreed to implement cargo and passenger charters at the same time.

#### Oil Prices - Not a Problem, Yet

12. (C) Taiwan air carriers have been able to manage rising oil prices to date. CAL's Wei claims the firm earns USD 5 to 6 million per month hedging oil and can continue to do so until the middle of 2006. Cathay Pacific Taiwan General Manager told AIT/T that although passenger fuel surcharges do not make up the additional costs of higher prices, cargo fuel surcharges do. DHL's Chen confessed with some embarrassment that DHL is actually making more money than previously thanks to fuel surcharges but predicted it wouldn't last.

#### Comment - Even Taiwan Carriers will Bypass Taiwan

13. (C) EVA and CAL have generally earned higher profits from cargo than passenger traffic. Their strategies in the face of declining volumes, lack of direct links and higher oil prices show that these carriers are determined to stay competitive in the global air cargo market. If Taiwan air cargo exports and imports continue to fall, which appears likely, EVA and CAL will need to invest more resources in PRC ventures. Some of these resources could be invested in Taiwan operations if the Chen Administration and the PRC were to move more quickly on cross-Strait direct links. Unfortunately for Taiwan, this economic factor is unlikely to have much impact on the political calculations driving cross-Strait policy. End comment.  
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